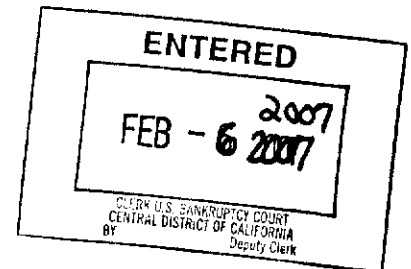
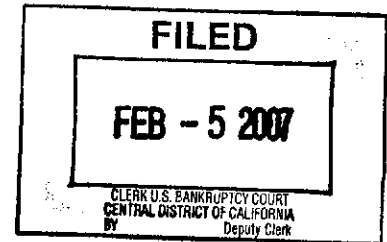


**FOR PUBLICATION**



**UNITED STATES BANKRUPTCY COURT  
CENTRAL DISTRICT OF CALIFORNIA**

In re

DONALD J. BRUN,

Debtor.

JAMES J. JOSEPH, Chapter 7 Trustee,

Plaintiff,

vs.

EVA MADRAY,

Defendants.

Case No. SA 05-18954 JR

Adv. No. SA 05-01622 JR

Chapter 7

**MEMORANDUM OPINION**

Date: December 13, 2006

Time: 3:30 P.M.

Place: Courtroom 5A

**I. INTRODUCTION**

On December 1, 2005, James J. Joseph ("Plaintiff"), the chapter 7 trustee, commenced an adversary proceeding against Eva Madray ("Defendant") to recover the value of Donald J. Brun's ("Debtor") interest in real property located at 356 "Y" Place, Laguna Beach, California (the "Property"). On November 6, 2006, Defendant moved for summary adjudication that Plaintiff's recovery is limited to the value of the "asset" as defined by §§ 3439.01 et seq. of the California Civil Code

1 ("Civil Code"), that is the non-exempt net equity in the Property  
2 at the time of the transfer. Plaintiff opposed and filed a  
3 cross-motion for summary adjudication to recover the current  
4 value of the Property. Following a hearing on December 13, 2006,  
5 I took the matter under submission to determine if applicable  
6 California law limits Plaintiff's recovery under § 550 of the  
7 Bankruptcy Code.<sup>1</sup>

## 8 II. JURISDICTION

9 I have jurisdiction over this matter under 28 U.S.C.  
10 § 157(b)(1). This is a core proceeding under 28 U.S.C. §§ 157  
11 (b)(2)(A), (F), (O).

## 12 III. STATEMENT OF FACTS

13 On August 10, 1998, Debtor acquired the Property. On April  
14 24, 2002, Debtor executed a grant deed (the "Deed") transferring  
15 his interest in the Property to Defendant. The Deed was recorded  
16 the next day.

17 On October 12, 2005, Debtor filed a voluntary chapter 7  
18 petition. On December 1, 2005, Plaintiff filed a complaint (the  
19 "Complaint") to avoid the transfer of Debtor's interest in the  
20 Property and recover the value of that interest. In the  
21 Complaint, Plaintiff alleged that the transfer of the Property to  
22 Defendant (the "Transfer") is avoidable as a fraudulent transfer  
23 pursuant to § 544 of the Code and §§ 3439.01 et seq. of the Civil

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24  
25 <sup>1</sup> Unless otherwise indicated, all chapter, section, and rule  
26 references are to the Bankruptcy Code (the "Code"), 11 U.S.C.  
27 §§ 101-1330, prior to its amendment by the Bankruptcy Abuse  
28 Prevention and Consumer Protection Act of 2005 (the "Act"), Pub.  
L. 109-8, 119 Stat. 23, because this case was filed before the  
Act's effective date (October 17, 2005), and to the Federal Rules  
of Bankruptcy Procedure (the "Rules"), Rules 1001-9036.

1 Code, and that the value of the Property is recoverable pursuant  
2 to Civil Code §§ 3439.05 and 3439.07.<sup>2</sup> Plaintiff prays for a  
3 judgment against Defendant for the total present-day market value  
4 of the property transferred.

5 On November 6, 2006, Defendant filed a motion (the "Motion")  
6 for summary adjudication that Plaintiff's recovery is limited to  
7 the value of the "asset" as defined by Civil Code §§ 3439.01 et  
8 seq., that is the non-exempt net equity in the Property at the  
9 time of the Transfer. Plaintiff opposed and filed a cross-motion  
10 for summary adjudication that his recovery is not limited by  
11 California law. Plaintiff argues that once the Transfer is  
12 determined to be avoidable pursuant to § 544(b) and § 3439.04, he  
13 can recover the Property or the current fair market value of the  
14 equity in the Property, including any appreciation, pursuant to  
15 § 550(a), regardless of the limitations imposed by §§ 3439 et  
16 seq. Following a hearing on December 13, 2006, I took the  
17 matter under submission to determine whether Plaintiff's recovery  
18 is limited to the amount of non-exempt net equity in the Property  
19 at the time of the Transfer.

#### 20 IV. DISCUSSION

21 "Section 544(b) of the Bankruptcy Code permits the Trustee  
22 to stand in the shoes of a creditor to assert any state law  
23 claims that a creditor may have." Kupetz v. Wolf, 845 F.2d 842,

24  
25 <sup>2</sup> Plaintiff and Defendant correctly recognize that, as  
26 discussed in further detail below, Plaintiff's recovery is  
27 governed by Code § 550, and not Civil Code §§ 3439.05 and  
28 3439.07. Therefore, as requested by the parties, I will  
determine whether applicable California law limits Plaintiff's  
recovery under § 550. However, Plaintiff is advised to amend the  
Complaint to assert his recovery claim under the proper statute.

1 845 (9th Cir. 1988). Specifically, § 544 of the Code provides  
2 that "the trustee may avoid any transfer of an interest of the  
3 debtor in property . . . that is voidable under applicable law by  
4 a creditor holding an [allowable] unsecured claim . . . ." 11  
5 U.S.C. § 544(b).

6 Under California law, an unsecured creditor may avoid a  
7 fraudulent "transfer" to the extent necessary to satisfy the  
8 creditor's claim.<sup>3</sup> See CAL. CIV. CODE §§ 3439.04, 3439.07. To the  
9 extent a transfer is voidable, the moving creditor may recover a  
10 judgment for the value of the "asset" transferred at the time of  
11 the transfer, or the amount necessary to satisfy the creditor's  
12 claim, whichever is less. Id. § 3439.08. A "transfer", as  
13 defined by California law, "means every mode, direct or indirect,  
14 absolute or conditional, voluntary or involuntary, of disposing  
15 of or parting with an asset or an interest in an asset, and  
16 includes payment of money, release, lease, and creation of a lien

17  
18 <sup>3</sup> A transfer is fraudulent if the debtor made the transfer  
or incurred the obligation as follows:

- 19 (1) With actual intent to hinder, delay, or  
20 defraud any creditor of the debtor.  
21 (2) Without receiving a reasonably equivalent  
22 value in exchange for the transfer or  
obligation, and the debtor either  
23 (A) Was engaged or was about to engage in a  
24 business or a transaction for which the  
remaining assets of the debtor were  
25 unreasonably small in relation to the  
business or transaction.  
26 (B) Intended to incur, or believed or  
27 reasonably should have believed that he or  
she would incur, debts beyond his or her  
ability to pay as they became due.

28 CAL. CIV. CODE § 3439.04(a).

1 or other encumbrance." Id. § 3439.01 (emphasis added). An  
2 "asset" means unencumbered, non-exempt equity in property of a  
3 debtor.<sup>4</sup> Id. Therefore, a creditor may avoid a debtor's  
4 fraudulent disposition of the unencumbered, non-exempt value in  
5 property to the extent of its claim.

6 Once a trustee demonstrates the right to avoid a transfer,  
7 "[the] trustee must then establish the amount of recovery"  
8 pursuant to § 550(a). See Acequia, Inc. v. Clinton (In re  
9 Acequia, Inc.), 34 F.3d 800, 809 (9th Cir. 1994) (emphasis in  
10 original). Section 550 provides in relevant part that:

11 [T]o the extent that a transfer is avoided  
12 under section 544, 545, 547, 548, 549,  
13 553(b), or 724(a) of this title, the trustee  
14 may recover, for the benefit of the estate,  
15 the property transferred, or, if the court so  
16 orders, the value of such property, from  
17 (1) the initial transferee of such transfer  
18 or the entity for whose benefit such transfer  
19 was made; or  
20 (2) any immediate or mediate transferee of  
21 such initial transferee.

22 11 U.S.C. § 550(a)(1)-(2). Put simply, § 550 identifies the  
23 parties liable for repayment of the avoided or avoidable  
24 transfer, and empowers the trustee to recover the property  
25

26 <sup>4</sup> Section 3439.01 provides in relevant part that:

27 (a) "Asset" means property of a debtor, but  
28 the term does not include, the following:

(1) Property to the extent it is encumbered  
by a valid lien.

(2) Property to the extent it is generally  
exempt under nonbankruptcy law.

(3) An interest in property held in tenancy  
by the entirety to the extent it is not  
subject to process by a creditor holding a  
claim against only one tenant.

1 transferred or its value for the benefit of the estate. See  
2 Crafts Plus+, Inc. v. Foothill Capital Corp. (In re Crafts  
3 Plus+), 220 B.R. 331, 334 (Bankr. W.D. Tex. 1998). Furthermore,  
4 § 550 "enunciates the separation between the concepts of avoiding  
5 a transfer and recovering from the transferee." H.R. REP. NO. 95-  
6 595, at 375 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6331; S.  
7 REP. NO. 95-989, at 90 (1978) reprinted in 1978 U.S.C.C.A.N. 5787,  
8 5876.

9 For this reason, courts have held that the amount of the  
10 trustee's recovery should not be limited by the amount of the  
11 creditor's claim. See Acequia, 34 F.3d at 809; see also Decker  
12 v. Voisenat (In re Serrato), 214 B.R. 219, 232 (Bankr. N.D. Cal.  
13 1997); Stalnaker v. DLC, Ltd. (In re DLC, Ltd.), 295 B.R. 593,  
14 607 (8th Cir. BAP 2003) (holding that a trustee may recover the  
15 entire transfer, as opposed to only the amount necessary to  
16 satisfy the creditors' claims). In Acequia, the debtor in  
17 possession commenced an action to recover, as fraudulent under §  
18 544(b) and Idaho law, certain pre-petition transfers by the  
19 debtor's shareholder, Clinton. Acequia, 34 F.3d at 804. The  
20 magistrate judge determined that the subject transfers were  
21 fraudulent, "[h]owever, reasoning that Acequia's avoidance rights  
22 under section 544(b) derive from those of its unsecured  
23 creditors, . . . limited the corporation's section 544(b)  
24 recovery to the total amount of unsecured claims against the  
25 bankruptcy estate." Id. at 807. On appeal, the Ninth Circuit  
26 ruled that the magistrate judge erred by imposing this cap on the  
27 debtor's § 544(b) recovery. Id. at 809. In reaching its  
28 decision, the Ninth Circuit emphasized the separation between the

1 concepts of avoiding a transfer and recovery from a transferee.  
2 Id. Consequently, the trustee may avoid a fraudulent transfer in  
3 excess of the amount of the unsecured creditors' claims where the  
4 recovery will accrue "for the benefit of the estate." Id. 809-  
5 11; see also Voisenat, 214 B.R. at 231-32 (holding that the  
6 limitation imposed by Civil Code § 3439.07, expressly limiting  
7 the avoidance of a transfer to the extent necessary to satisfy  
8 the creditor's claim, did not limit the trustee's recovery in  
9 bankruptcy).

10 However, courts in the Ninth Circuit have not been entirely  
11 consistent regarding the impact of the recovery limitations  
12 imposed by §§ 3439 *et seq.* on actions to avoid and recover  
13 pursuant to §§ 544(b) and 550(a). In Decker v. Tramiel (In re  
14 JTS Corp.), 2006 WL 2844581, \*5 (N.D. Cal. 2006) (slip copy), the  
15 trustee commenced an adversary proceeding to avoid the debtor's  
16 sale of certain real property for \$10,000,000 pursuant to  
17 § 544(b) and California law. Id. at \*2. While the bankruptcy  
18 court concluded that the sale was fraudulent, it reduced the  
19 amount of the transferee's liability by the amount he paid to the  
20 debtor pursuant to § 3439.08(d).<sup>5</sup> The trustee appealed, arguing  
21 that the bankruptcy court's calculation of liability was  
22 erroneous. The trustee argued that once the avoidability of the  
23 transfer is determined pursuant to state law, the amount of the

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24  
25 <sup>5</sup> Section 3439.07 provides that a creditor, subject to the  
26 limitations in § 3439.08, may obtain avoidance of a fraudulent  
27 transfer to the extent necessary to satisfy the creditor's claim.  
28 Section 3439.08(d) provides that "[n]otwithstanding voidability  
of a transfer . . . a good faith transferee . . . is entitled, to  
the extent of the value given the debtor for the transfer . . . a  
reduction in the amount of the liability on the judgment."

1 transfer is determined pursuant to § 550(a), and that any limit  
2 on liability imposed by state law should be disregarded. The  
3 district court disagreed. Specifically, the district court found  
4 persuasive the fact that two other courts had "assumed that state  
5 law setoff provisions like the one at issue are swept into 11  
6 U.S.C. § 544(b) along with provisions defining a fraudulent  
7 conveyance." Id. at \*5. Moreover, the court stated that while  
8 § 3439.08 is a limit on liability rather than on avoidability,  
9 "the statutory provision authorizing avoidance states expressly  
10 that a creditor may obtain avoidance 'subject to the limitations  
11 in Section 3439.08.'" Id. Therefore, the court held that the  
12 bankruptcy court properly permitted the transferee to set off the  
13 value he gave for the real property at issue. Id.

14 As can be seen from the above discussion, the interplay  
15 between the Code and California fraudulent conveyance law is far  
16 from settled. The parties have not cited, and I have not  
17 discovered any cases specifically deciding the issue here.  
18 Nonetheless, a plain reading of §§ 549 and 550, and Civil Code  
19 §§ 3439 *et seq.*, relevant case law, and general principles of  
20 bankruptcy law support the conclusion that Plaintiff may recover  
21 the current fair market value of any equity in the Property.

22 Here, Plaintiff seeks to avoid the transfer of Debtor's  
23 interest in the Property to Defendant via the Deed. Plaintiff  
24 may avoid the Transfer if a creditor holding an allowed claim  
25 could avoid the Transfer under applicable state law. See 11  
26 U.S.C. § 544(b). Under controlling California fraudulent  
27 conveyance law, e.g. §§ 3439.01, 3439.04, and 3439.07, a creditor  
28 could not avoid the Transfer in its entirety. Rather, a creditor



1 is permitted to avoid only a "transfer". A "transfer" is the  
2 disposition of an "asset", which excludes property encumbered by  
3 a valid lien or exempt under non-bankruptcy law. As such,  
4 property that is fully encumbered and/or exempt is not voidable  
5 as a fraudulent transfer. See Consolidated Pioneer Mortg.  
6 Entities v. San Diego Sav. & Loan (In re Consolidated Pioneer  
7 Mortg. Entities), 1999 WL 23156, \*1 (9th Cir. 1999) ("[P]roperty  
8 encumbered by a valid security interest is not recoverable under  
9 California law."). Accordingly, Plaintiff, standing in the shoes  
10 of a creditor proceeding under California law, is entitled to  
11 avoid the Transfer only to the extent that Debtor disposed of  
12 unencumbered, non-exempt property with the intent to defraud, or  
13 while insolvent. See Kendall v. Turner (In re Turner), 335 B.R.  
14 140, 145 (Bankr. N.D. Cal. 2005) (stating that under California  
15 law, only the transfer of the "asset" is avoided).

16 Based on the above analysis, Defendant argues that  
17 Plaintiff's recovery is limited to Debtor's equity interest in  
18 the Property at the time of the Transfer. Defendant emphasizes  
19 that § 550(a) does not permit Plaintiff to recover more than is  
20 avoidable under § 544(b) and California law. Defendant is  
21 correct that a trustee's recovery may be made only "to the extent  
22 the transfer is avoided." See 11 U.S.C. § 550(a). However, a  
23 trustee may recover, for the benefit of the estate, the property  
24 transferred or its value. Accordingly, while Plaintiff can avoid  
25 the Transfer only to the extent Debtor transferred equity in the  
26 Property, Plaintiff may recover the "value" of that equity  
27 interest pursuant to § 550(a).

28 The Code neither defines "value" nor indicates at what time

1 "value" is to be determined. See Hirsch v. Steinberg (In re  
2 Colonial Realty Co.), 226 B.R. 513, 525 (Bankr. D. Conn. 1998).  
3 Typically, courts equate "value" with the fair market value of  
4 the subject property at the time of the transfer. See Hirsch,  
5 226 B.R. at 525; see also Salven v. Munday (In re Kemmer), 265  
6 B.R. 224, 235 (Bankr. E.D. Cal. 2001); Tramiel, 2006 WL 2844581,  
7 \*6. This is especially true where the property depreciated in  
8 value after the transfer, or was not in the possession of the  
9 § 550 defendant. See Hirsch, 226 B.R. at 525; see also First  
10 Software Corp. v. Computers Assoc. Int'l. (In re First Software  
11 Corp.), 107 B.R. 417, 423 (D. Mass 1989); Hall v. Arthur Young &  
12 Co. (In re Computer Universe, Inc.), 58 B.R. 28, 32 (Bankr. M.D.  
13 Fla. 1986); 5 L. King, Collier on Bankruptcy ¶ 550.02[3] (15th  
14 ed. rev. 2001).

15 At least two courts have recognized that the trustee is  
16 entitled to recover the "greater of the value of the transferred  
17 property at the transfer date or the value at the time of the  
18 recovery." Collier on Bankruptcy, supra, ¶ 550.02[3]; see also  
19 Langhorne v. Warmus (In re American Way Serv. Corp.), 229 B.R.  
20 496, 530-31 (Bankr. S.D. Fla. 1999) ("[W]hen the property has  
21 appreciated, the trustee is entitled to recover the property  
22 itself, or the value of the property at the time of judgment");  
23 Govaert v. B.R.E. Holding Co., Inc. (In re Blitstein), 105 B.R.  
24 133, 137 (Bankr. S.D. Fla. 1989) ("[T]he Trustee is entitled to  
25 at least a money judgment in the amount of the greater of the  
26 value at the time of the transfer; or the value at the time of  
27 recovery less the value of improvements made."). This makes  
28 sense. As noted by Collier, this result is consistent with the

1 well-established purpose of § 550, to restore the estate to the  
2 position it would have occupied had the property not been  
3 transferred.<sup>6</sup> See Collier on Bankruptcy, supra, ¶ 550.02[3].  
4 Moreover, as stated by Plaintiff, a trustee typically has the  
5 ability to recover the property transferred, which would allow  
6 the estate to benefit from any appreciation. Section 550(e)  
7 demonstrates the intent of Congress that any appreciation not  
8 attributable to the actions of a good faith transferee inure to  
9 the benefit of the estate. Pursuant to § 550(e), a good faith  
10 transferee is entitled to a lien to secure the lesser of the cost  
11 of any improvements, or an increase in value as a result of such  
12 improvements.<sup>7</sup> See 11 U.S.C. § 550(e); see also Collier on  
13 Bankruptcy, supra, ¶ 550.02[3].

14 In sum, while California law governs whether and to what  
15 extent a transfer of property is voidable, the value of the  
16 avoided transfer, and therefore, the recovery is governed by

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17  
18 <sup>6</sup> Collier also notes that this result:

19 serves the equitable underpinnings of  
20 restorative justice by discouraging a "wait  
21 and see" approach by transferee defendants  
22 holding property, such as stock, that may be  
23 subject to wide, rapid swings in value on  
24 account of volatile markets. Likewise, as  
25 noted in the legislative record, 'a  
26 transferee has an opportunity to benefit by  
27 delay, and there are possibilities for abuse  
28 where the transferred property is  
appreciating substantially in value.

Collier on Bankruptcy, supra, ¶ 550.02[3].

<sup>7</sup> Improvements include physical additions or alterations to  
the property, repairs, the payment of taxes or secured debt, and  
preservation of the subject property. See 11 U.S.C. § 550(e).

1 § 550(a), irrespective of any recovery limitations imposed by  
2 California law. Therefore, Plaintiff may avoid the transfer of  
3 Debtor's interest in the Property to the extent it involved the  
4 transfer of unencumbered, non-exempt equity. Under § 550(a),  
5 Plaintiff may recover the property transferred, e.g. the "asset",  
6 or the current fair market value of the asset, less the cost or  
7 value of improvements, assuming such recovery is for the benefit  
8 of the estate. This interpretation is consistent with a plain  
9 reading of the Code, the Ninth Circuit's holding in Acequia, and  
10 the separation of the concepts of avoidance and recovery. To the  
11 extent that the reasoning in Tramiel supports a holding to the  
12 contrary, it is unpersuasive and not binding on this court.  
13 Accordingly, Plaintiff is entitled to summary judgment that he  
14 may recover the current fair market value of the property  
15 transferred for the benefit of the estate.


#### 16 V. CONCLUSION

17 While California law allows Plaintiff to avoid the Transfer  
18 only to the extent that Debtor disposed of unencumbered, non-  
19 exempt property, California law does not limit Plaintiff's  
20 recovery to the value of the "asset" at the time of the Transfer.  
21 Rather, Trustee may recover the appreciated value of the asset,  
22 provided it is for the benefit of the estate. Accordingly,  
23 partial summary judgment is granted for Plaintiff in that  
24 Plaintiff's recovery under §§ 544(b) and 550(a) is the value of  
25 the equity in the Property at the time of the Transfer, plus any  
26 appreciation, less any offset for property improvements.

27 This memorandum decision shall constitute my findings of  
28

1 fact and conclusions of law.

2 Dated: February 5, 2007

3   
4 JOHN E. RYAN  
5 United States Bankruptcy Judge  
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UNITED STATES BANKRUPTCY COURT  
CENTRAL DISTRICT OF CALIFORNIA

In re

DONALD J. BRUN,

Debtor.

Case No. SA 05-18954 JR

Adversary No. SA 05-01622 JR

NOTICE OF ENTRY OF ORDER

To:

OFFICE OF THE UNITED STATES TRUSTEE  
411 West Fourth Street  
Santa Ana, CA 92701-8000

LEONARD M. SHULMAN  
Shulman Hodges & Bastian LLP  
26632 Towne Centre Drive, Suite 300  
Foothill Ranch, CA 92610

THOMAS H. CASEY  
Law Offices of Thomas H. Casey, Inc.  
22342 Avenida Empresa, Suite 260  
Rancho Santa Margarita, CA 92688

You are hereby notified, pursuant to Bankruptcy Rule 9022 that  
a judgment or order entitled MEMORANDUM OPINION and ORDER DENYING  
DEFENDANT'S MOTION FOR PARTIAL SUMMARY JUDGMENT, AND GRANTING  
PLAINTIFF'S CROSS-MOTION FOR PARTIAL SUMMARY JUDGMENT was entered  
on FEB 6 2007.

I hereby certify that I mailed a copy of this notice to the  
above-named persons on FEB 6 2007.

Dated: FEB 6 2007

JON D. CERETTO

By Tina Quatt

Deputy Clerk